

Australia: Surging house prices built on a debt time-bomb

Alex Messenger
1 June 2010

A 20 percent increase in house prices over the past year, combined with a slowdown in housing loans since March, has set the scene for warnings that Australia's housing bubble is ready to burst. One international ratings firm has warned that offshore investors are nervous about what the end of the housing bubble would mean for Australian banks. Housing stock accounts for 40 percent of the assets of the banks. About 30 percent of the banks' funding is raised on the international market.

John Miles, a Fitch Ratings senior director, has told *Bloomberg* that bond markets are expressing concerns about the Australian bubble and that if those perceptions persist "there could be a problem." Miles said the Labor government's decision at the height of global financial panic in 2008 to guarantee the offshore borrowings of Australian banks (a guarantee that ended in April) "leaves a hangover of [guaranteed] debt that at some point is going to have to be refinanced. Banks are counting on investors having not only the appetite to absorb that guaranteed issuance, but also the appetite to meet the banks' demands for funding for growth."

News of bond market jitters mirrors an 8 percent fall in the value of the Australian dollar in recent weeks, with investors fleeing those currencies judged most exposed to a possible second global financial crash. As at the height of the global financial turmoil in October 2008, a seizing-up of financial markets would bankrupt the Australian banks. Australia's finance sector—and the country's economy more broadly—were only saved from that fate in 2008 by the government's offshore borrowings guarantee.

The dramatic house price increases of the past year,

coming as they have during the worst global downturn since the Great Depression, do not reflect the Australian economy's distinctive strength. Rather they express the overwhelming monopoly power of the large Australian banks and the Rudd Labor government's determination to protect those institutions. Armed with relatively cheap government-backed funds and assisted by a \$1 billion government subsidy for first home buyers, the "big four" (Commonwealth, Westpac, ANZ and National Australia Bank) not only survived bankruptcy, but over the course of the global downturn have increased considerably their already huge profits. They have achieved this by expanding their dangerous levels of housing debt.

According to the Australian Bureau of Statistics, mortgage lending has grown by \$200 billion since the crash of September 2008, an increase of almost 25 percent. That includes an additional \$40 billion for residential property investors (landlords). However, the growth in credit has not been matched by lending in other areas of the economy. In fact, overall bank lending fell by \$60 billion over the same period. In other words, the banks have systematically withdrawn business and construction investment and fallen back on what they know to be a relatively safe profit option—the mortgage repayments of working people. The banks are able to implement these economy-wide lending decisions because of their monopoly position: the four majors now account for 90 percent of all lending in Australia. Most of the funds of non-bank lenders are held on account with the major banks.

Skyrocketing house prices are the result of making credit available for housing purchases in conditions of underinvestment in new housing construction and a

growing population. Rising prices and interest rates are crippling already overburdened home-owners, including first home buyers. According to the Real Estate Institute of Victoria, between March 2009 and March 2010, the median price of a house in Melbourne, the capital of the state of Victoria, rose from \$400,000 to \$525,000. Housing affordability, which takes into account both prices and interest rates but not income reduction, has fallen 30 percent in the last year.

Moreover, despite Reserve Bank assurances to the contrary, its figures indicate that the banks are signing up borrowers no more cautiously than they did prior to the 2008 financial crisis. According to the RBA, 83 percent of new home owners are borrowing more than 90 percent of the purchase price of their home. A year ago, that figure was 73 percent.

Critically, when house prices go up, so do bank profits. According to figures compiled by the Australia Institute, in 2009 the four big banks made record underlying profits of \$35 billion before tax, a number that includes what the banks refer to as “doubtful debts”. Underlying pre-tax bank profits made up nearly 2.9 percent of GDP. And the \$35 billion figure meant an extraordinary 28.6 percent pre-tax return on equity. As the Australia Institute pointed out, if one treats 8 percent as the average return on business investment across the whole economy, the banks are earning pre-tax “super profits” in the order of 20 percent on investment. The fact that housing dominates bank assets means that the largest single portion of that profit is coming straight out of the pockets of working people.

As bond and currency market volatility indicates, there is little prospect of housing prices continuing to rise. The number of new owner-occupier borrowers fell by 4 percent in March, a development that prompted panicked front-page newspaper articles. The concern is well-founded. As economist Steve Keen has pointed out, because about 20 percent of the Australian economy’s aggregate demand is reliant on debt, any substantial “deleveraging” would have profound consequences for the economy and jobs. He calculates that the contribution of debt to aggregate demand since 1980 goes 90 percent towards explaining unemployment levels across that period. “Our economy

is demand-driven; as debt’s contribution to demand falls, aggregate demand slumps, and the number of jobs that can be supported by aggregate demand will also fall.”

While prices continue to rise and mortgages are paid, banks continue to make their profits and borrow on the international financial markets. This economic activity in turn helps to boost the growth rate. But when the housing bubble bursts—as it did in the US following the eruption of the sub-prime crisis—these processes all rapidly go into reverse. Bank profits fall, their international borrowings become more expensive and their viability is called into question. Economic activity declines, jobs are lost, working hours fall and mortgage defaults inevitably rise, which in turn compounds the crisis of the banking system.



To contact the WSWs and the
Socialist Equality Party visit:

wsws.org/contact